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302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

July 18, 2012

Board of Directors
Howard Regional Health System
3500 S. Lafountain Street
Kokomo, IN 46904

We have reviewed the audit report prepared by Blue & Co., LLC, Independent Public Accountants, for the period January 1, 2011 to December 31, 2011. In our opinion, the audit report was prepared in accordance with the guidelines established by the State Board of Accounts. Per the Independent Public Accountants' opinion, the financial statements included in the report present fairly the financial condition of the Howard Regional Health System, as of December 31, 2011 and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountant's report is filed with this letter in our office as a matter of public record.

STATE BOARD OF ACCOUNTS



CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2011 AND 2010

CPAs / ADVISORS



HOWARD REGIONAL HEALTH SYSTEM

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Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

We have audited the accompanying consolidated balance sheets of Howard Regional Health System (the System), as of December 31, 2011 and 2010, and the related consolidated statements of revenues, expenses, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Howard Regional Health System Foundation, Inc. (the Foundation), a blended component unit, whose statements reflect total assets of approximately \$3,282,000 and \$4,044,000 as of December 31, 2011 and 2010, respectively, and change in net assets of approximately (\$450,000) and \$272,000, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and in our opinion, insofar as it relates to the amounts for the Foundation, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources issued by the Indiana State Board of Accounts and the Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits, and the report of the other auditors, provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2011 and 2010, and its consolidated results of operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

The accompanying consolidated financial statements as of and for the year ended December 31, 2010, and the net assets as of January 1, 2010 have been restated as discussed in Note 2.

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information listed in the accompanying table of contents is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, changes in net assets and cash flows of the individual entities, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Blue & Co., LLC

May 31, 2012

REQUIRED SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

This section of Howard Regional Health System's (the System) annual consolidated financial statements presents background information and management's discussion and analysis (MD&A) of the System's consolidated financial performance during the year ended December 31, 2011 with comparable information for 2010 and 2009. This MD&A includes a discussion and analysis of the activities and results of the System, its blended component unit, Howard Regional Health System Foundation, and its majority owned subsidiaries as described in the notes to the consolidated financial statements. This MD&A should be read together with the consolidated financial statements included in this report.

The System has two county-owned facilities and operates under the Indiana County Hospital Law, Indiana Code 16-22. It has a licensed and staffed 150-bed acute regional hospital and a 30-bed regional rehabilitation hospital both located in Kokomo, Indiana serving a nine county region in north central Indiana. The System provides short-term inpatient and outpatient health care among other services.

The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

HIGHLIGHTS OF THE YEARS ENDED DECEMBER 31, 2011 AND 2010

Howard Regional Health System continues to offer a full range of inpatient and outpatient services. Even adjusting for a decline in volumes, the System continues to be one of the largest employers in Howard County with two hospitals on three campuses plus clinics in Greentown, Grissom, and Frankfort.

Work continues on the System's 2009-2012 strategic plan, which focuses on five major areas:

1. Outstanding quality
2. Superior service
3. Exceptional people
4. Ongoing growth
5. Consistent strength

In late 2010, a System-wide initiative to train and coach System leadership and staff began in partnership with the Studer Group, a nationally renowned firm devoted to teaching prescriptive tools and processes to create and sustain service and operational excellence. These efforts continued in 2011, and resulted in not only improved leadership and management performance, but also focused upon productivity improvements for the System. In conjunction with ongoing management diligence, the System was able to reduce 45 FTE's in 2011 without any layoff or reduction in force.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

Physician Recruitment

In order to fulfill our primary mission of providing exceptional quality care, we have made a commitment to further expand and secure a solid base of primary care and specialist physicians. In 2011, the System added two Adult Psychiatrists, Dr. Nicole Sims and Dr. Anu Thumuluri. Additionally, Dr. Clifford Evans, Orthopedics, was signed in 2011 with a projected start date of July 2012.

Electronic Health Record

Progress toward a System-wide Electronic Health Record (EHR) continued in 2011. The *Cerner* person-centric solution framework that was chosen to advance the digitization of individual electronic medical records to meet the needs of our hospital, providers and patients continued to be developed, implemented, and prepared for in 2011. The EHR, when completed, will represent a full conversion for the System in all areas, including not only traditional Hospital Information Systems, but also Computerized Physician Order Entry (CPOE), electronic inpatient charting, and outpatient office based solutions for the System's employed physicians. This technological process will not only ultimately improve efficiency and reduce waste. It will also improve the efficiency of information documentation and delivery, thus improving patient care.

Charity Care

The System provided approximately \$10.60 million of charity care to the community in 2011. This compares to \$9.70 million in 2010 or an increase of 9.5%. Charity care in 2009 was \$8.72 million.

Marketable Securities

The System is exposed to market risk related to changes in value of securities. The investment in mutual fund fixed income and equity securities was \$25.9 million as of December 31, 2011 compared to \$26.3 million as of December 31, 2010. These investments are carried at fair value, with changes in unrealized gains and losses being recorded in investment income (loss). During 2011, investment loss of approximately \$159,000 was recorded compared to investment income of approximately \$2.8 million in 2010.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

Interest Rate Swap Agreements

We are exposed to market risk related to changes in interest rates and we entered into interest rate swap agreements to manage our exposure to these fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions. The interest payments under these agreements are settled on a net basis. These derivatives have been recognized in the financial statements at their respective fair value. Changes in the fair value of these derivatives are included in the statement of revenues and expenses. During 2011, the System recognized an unrealized loss on the swap agreements of approximately \$4.7 million compared to an unrealized loss of approximately \$1.5 million in 2010.

Accreditations

During 2011, the following accreditations were achieved or renewed:

- The System is the only hospital in the region that does angioplasty or percutaneous coronary intervention (PCI) on site. This nonsurgical procedure is used to restore blood flow to blocked arteries, particularly the coronary arteries that feed the heart. Our accreditation by the Society of Chest Pain Centers means that we have a nationally-recognized approach to caring for patients who come to us with chest pain. To earn Chest Pain Center accreditation with PCI, we meet a comprehensive set of strict criteria and demonstrate commitment to reducing the time it takes to receive treatment. It also means that the accuracy and effectiveness of treatment can save lives.
- Commission on Accreditation of Allied Health Education Programs.
- American College of Surgeons Commission on Cancer, a consortium of professional organizations dedicated to improving survival and quality of life for cancer patients. The System is the only cancer program in Howard County to receive the accreditation.
- American College of Radiology (ACR). The ACR-accreditation demonstrates that the System has voluntarily undergone a comprehensive review process and meets nationally accepted high standards of care.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

- The System's West Campus Specialty Hospital Sleep Disorders Center is accredited by the American Academy of Sleep Medicine. The West Campus Sleep Disorders Center diagnoses and treats a variety of sleep disorders in adults and children over the age of four. These include sleep apnea, obstructive sleep apnea, insomnia, narcolepsy, restless leg syndrome and others.
- Inpatient imaging services by the American College of Radiology (ACR) in Ultrasound, as well as Imaging Center for CT and MRI. The System is the only ultrasound accredited facility listed on the ACR website.

Other accreditations and certifications include but are not limited to:

- The Intersocietal Commission for the Accreditation of Nuclear Medicine Laboratories
- The Intersocietal Commission for the Accreditation of Echocardiography Laboratories
- The Intersocietal Commission for the Accreditation of Vascular Laboratories
- American Association of Cardiovascular & Pulmonary Rehabilitation
- American College of Radiology accreditation in Mammography
- State of Indiana Family and Social Services Administration, Division of Mental Health
- American Diabetes Association
- Department of Health & Human Services, Health Care Financing Administration

LOOKING AHEAD TO 2012

In response to ongoing pressures on operations caused primarily by a downturn in the local economy (decreased utilization, payor mix, and reimbursement) as well as an assessment of the challenges of the future (health care reform, payor consolidation, declining governmental and commercial reimbursement, and increasing charity and bad debt), the System decided to pursue merger and affiliation opportunities. During 2011, multiple potential interested parties were evaluated, including for profit and not for profit organizations. On January 29, 2012, the System signed a Letter of Intent to negotiate and pursue an affiliation with Community Health Network, Inc. (CHNw). In May, 2012, both the System and CHNw boards approved an agreement for CHNw to acquire the assets and liabilities of the System. On May 22, 2012, the Board of Trustees of Howard Regional Health System as well as the Howard County Council and Howard County Commissioners, passed a resolution to approve the affiliation, with a signing date of May 31, 2012 and an effective date of July 1, 2012. CHNw will assume all debt of the System, and the System will become part of the CHNw Obligated Group for purposes of debt renewal. The affiliation entity will be named Community Howard Regional Health, Inc. (CHRH), and all net assets of the System will, upon the dissolution of the System as a County and Municipal Government entity as of June 30, 2012, be

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

transferred to CHRH. Local governance is a key component of this agreement, requiring that a majority of the CHRH board members be residents of Howard County, an acute care hospital will be maintained in Howard County, and a plan will be created to develop CHRH into a regional medical center.

Quality, patient safety and patient satisfaction will continue to be priorities and are key components as well of the affiliation agreement with CHNw. Working with guidelines provided by state and national healthcare organizations, the System will continue to be committed to providing exceptional quality, patient-centered care.

Strategic Cost Reduction/Operating Result Improvements

In anticipation of the healthcare reform and recognition of financial performance in 2010 that did not meet System objectives, the Board and Senior leadership initiated a Strategic Cost Reduction plan with a target of 10% improvement in overall expenses, or \$13 million. This goal was communicated to all employees seeking their input and ideas, and was initiated in early 2011. Areas of improvement include improved productivity management, supply chain initiatives, revenue cycle opportunities, and other efficiencies.

As a result of these initiatives, a net \$6.3 million improvement in operating income was achieved in 2011, consisting of \$4.1 million in cost reductions and \$2.2 million increase in net revenues. Improvements were realized from productivity gains, benefit reductions, and other general expense management, as well as growth in physician and outpatient volumes. These efforts continued into 2012, as a Performance Improvement Project was completed utilizing various consultants in 2011 to further identify areas of opportunity. These areas include improvement in affiliate performance, physician office revenue cycle, supply chain management, and further productivity efficiencies. With the planned affiliation with CHNw, improvement in total operating results is anticipated through not only these items noted, but overall improvement in purchasing terms, development of a Regional Medical Center Plan, access to primary care and specialty physicians, and CHNw System-wide initiatives.

USING THIS ANNUAL REPORT

The System's consolidated financial statements consist of the following statements – a Balance Sheet; a Statement of Revenues, Expenses and Changes in Net Assets; and a Statement of Cash Flows. These consolidated financial statements and related notes provide information about the activities and the financial position of the System.

The Consolidated Balance Sheet includes all of the System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to System creditors (liabilities).

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

All of the current year's revenue earned and expenses incurred as well as other changes in net assets are accounted for in the Consolidated Statement of Revenues, Expenses and Changes in Net Assets.

Finally, the Consolidated Statement of Cash Flows' purpose is to provide information about the System's cash flows from operating activities, financing activities including capital additions, and investing activities. This statement provides information on the sources and uses of cash and the change in cash balance during the year.

THE BALANCE SHEET AND STATEMENT OF REVENUES AND EXPENSES

One of the most important questions asked about the System's finances is, "Is the System as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues and expenses report information about the System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the System's net assets and changes in them. Think of the System's net assets—the difference between assets and liabilities—as one way to measure the System's financial health, or financial position. Over time, increases or decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. Consider other nonfinancial factors, however, such as changes in the System's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the System.

Table 1 – Balance Sheets

	2011	2010	2011-2010 Change	2009	2010-2009 Change
Current assets	\$ 51,735,094	\$ 56,486,920	\$ (4,751,826)	\$ 64,633,686	\$ (8,146,766)
Assets whose use is limited	7,727,054	7,826,641	(99,587)	829,183	6,997,458
Capital assets, net	89,474,289	90,013,218	(538,929)	84,012,667	6,000,551
Other assets	1,506,963	1,684,382	(177,419)	1,767,749	(83,367)
	<u>\$ 150,443,400</u>	<u>\$ 156,011,161</u>	<u>\$ (5,567,761)</u>	<u>\$ 151,243,285</u>	<u>\$ 4,767,876</u>
Current liabilities	\$ 25,256,256	\$ 22,076,422	\$ 3,179,834	\$ 43,067,072	\$ (20,990,650)
Long-term liabilities	67,671,112	66,924,607	746,505	33,711,176	33,213,431
Total liabilities	92,927,368	89,001,029	3,926,339	76,778,248	12,222,781
Net assets	<u>57,516,032</u>	<u>67,010,132</u>	<u>(9,494,100)</u>	<u>74,465,037</u>	<u>(7,454,905)</u>
	<u>\$ 150,443,400</u>	<u>\$ 156,011,161</u>	<u>\$ (5,567,761)</u>	<u>\$ 151,243,285</u>	<u>\$ 4,767,876</u>

Total assets decreased approximately \$5.6 million from December 31, 2010. Current assets decreased due to the decrease in cash and cash equivalents of \$4.2 million between years.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

Liabilities increased approximately \$3.9 million from December 31, 2010 mainly related to an increase in accounts payable (\$1.8 million) and interest rate swap liabilities (\$4.7 million).

The 2010-2009 change in total assets of approximately \$4.8 million is due to capital additions in 2010. The change between current assets and assets whose use is limited relates to the current versus long term classification of assets whose use limited.

The 2010-2009 change in total liabilities of approximately \$12.2 million was mainly the result of an increase in accounts payable \$3.9 million, capital lease obligations \$7.6 million and interest rate swap liabilities increasing \$1.5 million.

The 2011 net assets decreased approximately \$9.5 million from December 31, 2010 mainly due to lower income from operations and decreases in nonoperating revenues and expenses from investment income and the change in the unrealized gain (loss) in the interest rate swaps. The 2010 net assets decreased \$7.5 million from 2009 due to an operating loss, nonoperating revenues and expenses and the change in the unrealized loss in the interest rate swaps.

Table 2 – Statements of Revenues and Expenses and Changes in Net Assets

	2011	2010	2011-2010 Change	2009	2010-2009 Change
Total revenues	\$ 149,134,270	\$ 146,936,468	\$ 2,197,802	\$ 157,867,028	\$ (10,930,560)
Salaries and benefits	69,652,551	75,558,806	(5,906,255)	79,219,704	(3,660,898)
Supplies and drugs	30,477,079	29,238,541	1,238,538	27,570,181	1,668,360
Purchased services	10,531,757	8,929,971	1,601,786	10,070,495	(1,140,524)
Depreciation and amortization	9,348,513	9,687,014	(338,501)	9,909,307	(222,293)
Other	27,187,228	27,907,752	(720,524)	27,592,248	315,504
Total operating expenses	147,197,128	151,322,084	(4,124,956)	154,361,935	(3,039,851)
Operating income (loss)	1,937,142	(4,385,616)	6,322,758	3,505,093	(7,890,709)
Nonoperating revenues (expenses), net	(10,346,730)	(2,263,113)	(8,083,617)	6,771,322	(9,034,435)
Change in net assets before capital distributions	(8,409,588)	(6,648,729)	(1,760,859)	10,276,415	(16,925,144)
Capital distributions	(1,084,512)	(806,176)	(278,336)	(1,837,063)	1,030,887
Change in net assets	(9,494,100)	(7,454,905)	(2,039,195)	8,439,352	(15,894,257)
Net assets					
Beginning of year	67,010,132	74,465,037	(7,454,905)	66,025,685	8,439,352
End of year	\$ 57,516,032	\$ 67,010,132	\$ (9,494,100)	\$ 74,465,037	\$ (7,454,905)

Total revenues increased approximately \$2.2 million from December 31, 2010 mainly due to net patient service revenue and overall utilization. While gross patient service revenue increased \$24.3 million over 2010, contractual adjustments, charity care and bad debts increased \$22.7 million due to changes in payor mix and changes in overall utilization. Expenses decreased approximately \$4.1 million mainly through salaries and benefits as staffing was monitored based on overall utilization and efficiencies. Together, operating income (loss) increased \$6.3 million over 2010 to a total operating income of \$1.9 million in 2011.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

Net nonoperating expense for 2011 was \$10.3 million, an increase of approximately \$8.1 million from 2010. The performance improvement project of approximately \$2.3 million and the unrealized loss on the interest rate swap agreement were the main contributing factors.

The 2010-2009 decrease in change in net assets of approximately \$15.9 million was due to operations and the unrealized loss on interest rate swaps.

STATEMENT OF CASH FLOWS

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in the cash balance during the reporting period?"

A summary of cash flows follows:

Cash Flows Data	2011	2010	2011-2010 Change	2009	2010-2009 Change
From operating activities	\$ 13,579,119	\$ 11,793,804	1,785,315	\$ 12,872,769	\$ (1,078,965)
From capital and related financing activities	(19,164,383)	(13,777,348)	(5,387,035)	(19,171,976)	5,394,628
From investing activities	239,900	2,982,581	(2,742,681)	3,005,009	(22,428)
Change in cash and cash equivalents	<u>\$ (5,345,364)</u>	<u>\$ 999,037</u>	<u>\$ (6,344,401)</u>	<u>\$ (3,294,198)</u>	<u>\$ 4,293,235</u>

Total cash and cash equivalents decreased approximately \$5.3 million in 2011 with cash flows from operating activities generating \$13.6 million in 2011. Capital and related financing activities used cash of \$19.2 million mainly for property additions, payments on long term debt and performance improvement projects. Investing activities relate mainly to investment income and classification between investments and cash equivalents.

Changes from 2009 to 2010 were mainly in capital and related financing activities (an increase of \$5.4 million).

SOURCES OF REVENUE

The System's revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the negotiated payment rates for such services. The gross charges typically do not reflect what is actually paid. The System has entered into agreements with third party payors, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates per diagnoses or discounts from gross charges. The

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

System receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes.

Revenues from Medicare and Medicaid programs increased to 62% of gross revenues in 2011 from 60% in 2010. Legislative changes continue to limit or reduce the levels of payments from these programs. The approximate percentages of gross patient revenues were:

	2011	2010	2009
Medicare	51%	48%	47%
Medicaid	11%	12%	11%
Blue Cross/Blue Shield	20%	19%	20%
Commercial	12%	13%	13%
Other	6%	8%	9%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

CAPITAL ASSETS

	2011	2010	2009
Land	\$ 1,002,878	\$ 1,002,878	\$ 1,002,878
Land improvements	6,617,870	6,567,713	6,554,573
Buildings and improvements	97,780,598	96,924,110	95,378,684
Equipment	62,527,181	63,614,006	62,421,888
Construction in progress	18,586,100	12,195,376	3,827,495
	<u>186,514,627</u>	<u>180,304,083</u>	<u>169,185,518</u>
Accumulated depreciation	97,040,338	90,290,865	85,172,851
	<u>\$ 89,474,289</u>	<u>\$ 90,013,218</u>	<u>\$ 84,012,667</u>

Gross additions to capital assets were approximately \$8.7 million before retirements of approximately \$2.5 million. Depreciation expense was approximately \$9.3 million before retirements of approximately \$2.5 million for a net decrease in capital assets of approximately \$500,000.

LONG TERM DEBT

As of December 31, 2011, the System had \$63.3 million in short term and long term notes, bonds and capital leases outstanding, a decrease from the \$67.3 million as of December 31, 2010. The decrease relates to the regular principal payments with no additional borrowings. More detailed information about the System's long term debt is presented in the notes to the consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2011 AND 2010

ECONOMIC OUTLOOK

Management believes that the healthcare industry operating margins will continue to be under significant pressure, due to both changes in payor mix and also downward pressure on reimbursements from the Medicare and Medicaid programs as well as Commercial Insurers. The ongoing challenge facing the System and the entire healthcare market is to continue to provide quality patient care in a competitive environment and to attain reasonable rates for the services it provides while managing its costs. One of the biggest challenges facing the System and all healthcare systems is the recruitment and retention of physicians, both primary care and specialty based. For these reasons, as well as the prospect of continued challenges under the health reform law and other governmental programs, the System believes that its affiliation with CHNw is a positive development to better address these challenges.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the System at 3500 South Lafountain Street, Kokomo, Indiana 46904, (765) 453-0702.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2011 AND 2010

ASSETS		
	2011	2010
Current assets		
Cash and cash equivalents	\$ 5,652,878	\$ 9,901,301
Investments	19,838,367	21,244,299
Patient accounts receivable, net of estimated uncollectibles of \$6,817,526 in 2011 and \$10,186,671 in 2010	16,946,294	16,288,081
Other receivables	2,561,509	2,274,100
Inventories and other current assets	5,821,046	5,894,139
Current portion of assets whose use is limited	915,000	885,000
Total current assets	51,735,094	56,486,920
Assets whose use is limited		
Internally designated	7,942,426	7,965,309
Held by trustee	76,049	80,021
Donor restricted	623,579	666,311
Total assets whose use is limited	8,642,054	8,711,641
Less current portion	915,000	885,000
Noncurrent portion of assets whose use is limited	7,727,054	7,826,641
Capital assets, net	89,474,289	90,013,218
Other assets	1,506,963	1,684,382
Total assets	<u>\$ 150,443,400</u>	<u>\$ 156,011,161</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2011 AND 2010

LIABILITIES AND NET ASSETS

	2011	2010
Current liabilities		
Accounts payable and accrued expenses	\$ 9,240,607	\$ 7,470,182
Accrued liabilities	8,483,639	8,396,951
Other current liabilities	1,017,358	724,230
Estimated third party settlements	1,908,894	771,670
Current portion of revenue bonds payable	915,000	885,000
Current portion of loans payable	902,485	878,802
Current portion of capital lease obligations	2,788,273	2,949,587
Total current liabilities	25,256,256	22,076,422
Long term debt		
Revenue bonds payable	45,420,000	46,335,000
Capital lease obligations	2,990,767	4,838,084
Loans payable	10,266,258	11,454,401
Total long term debt	58,677,025	62,627,485
Interest rate swap liabilities and other	8,994,087	4,297,122
Total liabilities	92,927,368	89,001,029
Net assets		
Invested in capital assets, net of related debt	26,284,916	22,672,344
Designated		
For debt service	76,049	80,021
Expendable for capital improvements	7,942,426	7,965,309
Total designated net assets	8,018,475	8,045,330
Restricted - donor restricted	623,579	666,311
Unrestricted	20,375,118	33,325,781
Net assets - controlling interest	55,302,088	64,709,766
Non-controlling interest	2,213,944	2,300,366
Total net assets	57,516,032	67,010,132
Total liabilities and net assets	\$ 150,443,400	\$ 156,011,161

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Revenues		
Net patient service revenue	\$ 135,860,028	\$ 134,209,448
Other	13,274,242	12,727,020
Total revenues	149,134,270	146,936,468
Operating expenses		
Salaries and wages	57,821,044	61,839,363
Employee benefits	11,831,507	13,719,443
Medical professional fees	6,702,296	6,974,507
Medical supplies and drugs	30,477,079	29,238,541
Purchased services	10,531,757	8,929,971
Equipment rentals	7,571,546	7,174,729
Utilities and telephone	3,017,005	2,982,783
Insurance	1,307,226	1,182,381
Depreciation and amortization	9,348,513	9,687,014
Other	8,589,155	9,593,352
Total expenses	147,197,128	151,322,084
Operating income (loss)	1,937,142	(4,385,616)
Nonoperating revenues (expenses)		
Investment income (loss)	(158,810)	2,799,689
Interest expense	(3,043,496)	(3,115,018)
Unrealized loss on interest rate swaps	(4,696,965)	(1,540,599)
Performance improvement project	(2,339,956)	-0-
Other nonoperating expenses	(107,503)	(407,185)
Total nonoperating revenues (expenses), net	(10,346,730)	(2,263,113)
Change in net assets before capital distributions	(8,409,588)	(6,648,729)
Capital distributions	(1,084,512)	(806,176)
Change in net assets	(9,494,100)	(7,454,905)
Less amount attributable to non-controlling interest	86,422	173,938
Change in net assets attributable to controlling interest	\$ (9,407,678)	\$ (7,280,967)
Change in net assets	\$ (9,494,100)	\$ (7,454,905)
Net assets, beginning of year	67,010,132	74,465,037
Net assets, end of year	\$ 57,516,032	\$ 67,010,132

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Operating activities		
Cash received from patients and third party payors	\$ 136,339,039	\$ 136,885,372
Cash paid to vendors for goods and services	(66,468,299)	(62,102,612)
Cash paid for employee wages and benefits	(69,565,863)	(74,998,657)
Other receipts, net	13,274,242	12,009,701
Net cash flows from operating activities	13,579,119	11,793,804
Capital and related financing activities		
Acquisition and construction of capital assets	(8,629,180)	(5,407,485)
Loss on disposal of property and equipment	(9,148)	(136,909)
Distributions to non-controlling interest	(1,084,512)	(806,176)
Performance improvement project	(2,339,956)	-0-
Cash paid for Interest on long term debt	(3,043,496)	(3,115,018)
Principal payments on long term debt	(4,058,091)	(4,311,760)
Net cash flows from capital and related financing activities	(19,164,383)	(13,777,348)
Investing activities		
Investment income (loss)	(158,810)	2,799,689
Investment in affiliated companies, net	177,419	83,367
Other nonoperating revenues and expenses	(107,503)	(407,185)
Purchases of investments and assets whose use is limited	(5,811,072)	(4,411,587)
Sales of investments and assets whose use is limited	6,139,866	4,918,297
Net cash flows from investing activities	239,900	2,982,581
Net change in cash and cash equivalents	(5,345,364)	999,037
Cash and cash equivalents, beginning of year	13,568,861	12,569,824
Cash and cash equivalents, end of year	<u>\$ 8,223,497</u>	<u>\$ 13,568,861</u>
Reconciliation of cash and cash equivalents		
Included in current assets	\$ 5,652,878	\$ 9,901,301
Included in investments	2,483,658	3,576,654
Included in assets whose use is limited - internally designated	10,912	10,885
Included in assets whose use is limited - held by trustee	76,049	80,021
Cash and cash equivalents, end of year	<u>\$ 8,223,497</u>	<u>\$ 13,568,861</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Reconciliation of operating income (loss) to net cash flows from operating activities		
Operating income (loss)	\$ 1,937,142	\$ (4,385,616)
Adjustments to reconcile operating income (loss) to net cash flows from operating activities		
Depreciation and amortization	9,348,513	9,687,014
Bad debts	12,534,405	10,910,433
Changes in operating assets and liabilities		
Patient accounts receivable	(13,192,618)	(9,924,407)
Other receivables	(287,409)	296,150
Estimated third party settlements	1,137,224	972,579
Inventory and other assets	73,093	364,591
Accounts payable and accrued expenses	1,648,953	3,551,104
Accrued liabilities and other liabilities	86,688	560,149
Other current liabilities	293,128	(238,193)
Net cash flows from operating activities	<u>\$ 13,579,119</u>	<u>\$ 11,793,804</u>
Noncash capital and related financing activities		
Capital asset purchases in accounts payable	\$ 121,473	\$ 377,426
Capital lease obligations incurred for use of capital assets	\$ -0-	\$ 9,971,787

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Howard Regional Health System (the System) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code (IC) 16-22. The System provides short-term inpatient and outpatient health care among other services. The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present the System (primary government) and its significant component units. The component units discussed below are included in the System's reporting entity because of the significance of their operational or financial relationships with the System. Blended component units, although legally separate entities are in substance part of the government's operations and exist solely to provide services for the government; data from these units is consolidated with data of the primary government.

Basis of Consolidation

Howard Regional Health System Foundation, Inc. (the Foundation) is a blended component unit of the System. The Foundation is a separate not-for-profit entity organized to support the operations of the System. Financial statements for the Foundation can be obtained by contacting the Foundation office.

Other component units included in the consolidated financial statements based on the System's control of these entities are:

- Howard Regional Specialty Care, LLC (Specialty Care)
- Midwest Racquetball, Inc. dba Kokomo Sports Center
- Howard Community Surgery Center, LLC (Surgery Center)
- The Imaging Center of North Central Indiana, Inc. (Imaging Center)
- Andrew J. Mandery, MD, LLC (Mandery)

All significant intercompany transactions have been eliminated in the consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Enterprise Fund Accounting

The System utilizes the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the System has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Investments

Certificates of deposit, demand deposits, money market funds and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at contract value which approximates fair value.

Mutual funds are reported at fair value. Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating income in the consolidated statements of revenues, expenses and changes in net assets.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Patient Accounts Receivable and Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The System is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The System is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG).

The System is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the System's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

These programs have audited the year-end cost report filed with the Medicare program through December 31, 2006 with differences reflected as deductions from revenue in 2011. Amounts for unresolved cost reports for 2007 through 2011 are reflected in estimated third-party settlements on the consolidated balance sheets. The difference between computed reimbursement amounts and interim reimbursement amounts is reflected as a receivable from or payable to the third-party program. No cost reports were settled during 2011 and 2010.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying consolidated financial statements.

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges less an allowance for contractual adjustments and interim payment advances. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the System's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Inventories

Inventories are valued at the lower of cost or market with cost being determined using weighted-average method. Inventories consist primarily of medical supplies and pharmaceuticals.

Assets Whose Use is Limited

Assets whose use is limited are stated at fair value in the consolidated financial statements. These assets include investments designated by the System's Board of Trustees for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service and capital expenditures. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities and mutual funds.

Investment income (loss), to the extent not capitalized, is reported as nonoperating income in the consolidated statements of revenues, expenses and changes in net assets.

Charity Care

The System provides care without charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy on a sliding scale on the basis of financial need. Because the System does not pursue collection of approved charity care balances, the charges are not reflected in net revenue. Rather, charges approved for charity are posted to gross revenue and subsequently written off as a charity adjustment before the resulting net patient service revenue.

Of the System's total expenses reported (approximately \$147,200,000 and \$151,300,000 during 2011 and 2010, respectively), an estimated \$4,128,000 and \$4,141,000 arose from providing services to charity patients during 2011 and 2010, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Systems' total expenses divided by gross patient service revenue.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The System provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and fixed equipment	4-50 years
Major moveable equipment	5-15 years

Net Assets

Net assets of the System are classified in various components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets consist of debt service, capital improvement and other designations and held by the Foundation. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt.

Non-controlling Interest

Non-controlling interests represent the portion of the net assets that is attributable to investors that are external to and not included in the System's consolidated financial statements.

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

The System's consolidated statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services which is the Hospital's principal activity. Contributions and investment income are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, excluding interest costs and other debt related costs.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

As the result of debt covenant compliance requirements related to 2010, the System recorded a nonoperating expense in 2011 of approximately \$2,300,000 for a performance improvement project related to mitigating conditions for recent operating losses, decreased utilization, reduced reimbursement and changes in payor mix. This project focused on the implementation of services to increase overall utilization, revenue enhancement strategies and the development of medical staff as well as a reduction and control of certain expenditures.

Consolidated Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of 90 days or less from the date of purchase.

Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Capitalized interest was approximately \$238,000 and \$237,000 for 2011 and 2010, respectively.

Bond Issue Costs

The System provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs net of accumulated amortization were approximately \$553,000 and \$590,000 as of December 31, 2011 and 2010, respectively. Annual amortization expense related to bond issue costs is approximately \$31,000.

Income Taxes

The System is a governmental instrumentality organized under Title 16, Article 12, of the Indiana statutes. The System is exempt from federal income tax under Section 115 of the Internal Revenue Code of 1986 as a not-for-profit organization under Section 501(c)(3). As such, the System is generally exempt from income taxes. As a governmental entity, the System is not required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

The Foundation and Imaging Center, blended component units of the System, are tax-exempt organizations under Internal Revenue Code 501(c)(3). As such, the Foundation and Imaging Center are generally exempt from income taxes. However, the Foundation and Imaging Center are required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The blended component units of Specialty Care, Surgery Center and Mandery are organized as limited liability companies, whereby net taxable income is taxed directly to the members and not these entities. Thus, the consolidated financial statements do not include any provision for Federal or state income taxes.

The blended component unit of Kokomo Sports Center is a corporation subject to Federal and state income taxes. Income taxes for this entity is provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxed currently due plus deferred taxes. However, the effects of recording a deferred tax provision have been deemed immaterial and have not been recorded in the accompanying consolidated financial statements.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the System (and its affiliates) and recognize a tax liability if the System has taken an uncertain position that more likely than not would not be sustained upon examination by various Federal and state taxing authorities. Management has analyzed the tax positions taken by the System and has concluded that as of December 31, 2011 and 2010, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying consolidated financial statements. The System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

These entities have filed their federal and state income tax returns for periods through December 31, 2010. These income tax returns are generally open to examination by the relevant taxing authorities for a period of three years from the later of the date the return was filed or its due date (including approved extensions).

Compensated Absences

The System's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 480 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheets.

Litigation

The System is involved in litigation arising in the normal course of business. After consultation with the System's legal counsel, management estimates that these matters will be resolved without material adverse effect on the System's future financial position, results from operations or cash flows.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Risk Management

The System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were approximately \$721,000 and \$875,000 in 2011 and 2010, respectively.

Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries a claims made basis insurance policy covering the System's \$250,000 of exposure per claim.

Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified for comparative purposes to conform to the current year presentation. The reclassifications had no effect on the previously reported consolidated net assets and consolidated change in net assets, except as discussed in Note 2 to the consolidated financial statements.

Electronic Health Records (EHR) Incentive Payments

The System receives EHR incentive payments under the Medicare and Medicaid programs. To qualify for the EHR incentive payments, the System must meet "meaningful use" criteria that become more stringent over time. The System periodically submits and attests to its use of certified EHR technology, satisfaction of meaningful use objectives, and various patient data. These submissions generally include performance measures for each annual EHR reporting period (Federal fiscal year ending September 30). The related EHR incentive payments are paid out over a four year transition schedule and are based upon data that is captured in the System's cost reports. The payment calculation is based upon an initial amount as adjusted for discharges, Medicare and Medicaid utilization using inpatient days multiplied by a factor of total charges excluding charity care to total charges, and a transitional factor that ranges from 100% in first payment year and thereby decreasing by 25% each payment year until it is completely phased out in the fifth year.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The System recognizes EHR incentive payments as grant income when there is reasonable assurance that the System will comply with the conditions of the meaningful use objectives and any other specific grant requirements. In addition, the financial statement effects of the grants must be both recognizable and measurable. During 2011 and 2010, the System recognized approximately \$464,000 and \$-0-, respectively, in EHR incentive payments as grant income using the ratable recognition method. Under the ratable recognition method, the System recognizes income ratably over the entire EHR reporting period when it is reasonably assured at the outset of the EHR reporting period that it will comply with the minimum requirements of the program.

EHR incentive income is included in other revenue in the consolidated statement of revenues, expenses and changes in net assets. EHR incentive income recognized is based on management's estimate and amounts are subject to change, with such changes impacting operations in the period the changes occur.

Receipt of these funds is subject to the fulfillment of certain obligations by the System as prescribed by the programs, subject to future audits and may be subject to repayment upon a determination of noncompliance.

Subsequent Events

The System evaluates events or transactions occurring subsequent to consolidated balance sheet date for recognition and disclosure in the accompanying consolidated financial statements through the date the consolidated financial statements are issued which is May 31, 2012.

2. RESTATEMENT

The accompanying consolidated financial statements as of and for the year ended December 31, 2010, and the net assets as of December 31, 2009, have been restated to reflect a correction in the System's recorded net realizable value of patient accounts receivable. As a result of management's review of its methodology to estimate the net realization of patient accounts receivable, management determined that valuation allowances did not sufficiently incorporate historical collections against certain patient charges. The net realizable value of the System's patient accounts receivable was overstated by approximately \$1,973,000 as of December 31, 2010 and \$2,690,000 as of December 31, 2009.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The following is a summary of the restatement for 2010:

	December 31, 2010		
	Originally Reported	Adjustment	Restated
Consolidated balance sheet			
Patient accounts receivable	\$ 18,260,700	\$ (1,972,619)	\$ 16,288,081
Total current assets	\$ 58,459,539	\$ (1,972,619)	\$ 56,486,920
Net assets - unrestricted	\$ 35,287,515	\$ (1,972,619)	\$ 33,314,896
Total net assets	\$ 68,982,751	\$ (1,972,619)	\$ 67,010,132
Consolidated statement of revenues, expenses and changes in net assets			
Net patient service revenue	\$ 133,492,129	\$ 717,319	\$ 134,209,448
Total revenues	\$ 146,219,149	\$ 717,319	\$ 146,936,468
Operating loss	\$ (5,102,935)	\$ 717,319	\$ (4,385,616)
Change in net assets	\$ (8,172,224)	\$ 717,319	\$ (7,454,905)
Change in net assets attributable to controlling interest	\$ (7,998,286)	717,319	\$ (7,280,967)
Beginning net assets	\$ 77,154,975	\$ (2,689,938)	\$ 74,465,037
Consolidated statement of cash flows			
Operating activities			
Cash received from patients	\$ 136,168,053	\$ 717,319	\$ 136,885,372
Other receipts, net	\$ 12,727,020	\$ (717,319)	\$ 12,009,701
Reconciliation of operating loss to net cash flows from operating activities			
Operating loss	\$ (5,102,935)	\$ 717,319	\$ (4,385,616)
Bad debts	\$ 11,307,259	\$ (396,826)	\$ 10,910,433
Change in patient accounts receivable	\$ (9,603,914)	\$ (320,493)	\$ (9,924,407)

3. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements.

A summary of the reimbursement arrangements with major third-party payors is as follows:

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment System). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Prospective Payment System and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

The System is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. The System recognized reimbursement from these programs within net patient revenue of approximately \$2,927,000 and \$3,146,000 during 2011 and 2010, respectively. These programs are Federal programs administered by the state.

Other Payors

The System also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

The following is a summary of net patient service revenue for 2011 and 2010:

	2011	2010
Inpatient routine services	\$ 33,277,323	\$ 33,565,998
Inpatient ancillary services	91,506,696	91,205,584
Outpatient ancillary services	253,915,021	229,588,494
Gross patient service revenue	378,699,040	354,360,076
Contractual allowance	219,684,055	199,542,048
Charity care	10,620,552	9,698,147
Bad debts	12,534,405	10,910,433
Deductions from revenue	242,839,012	220,150,628
Net patient service revenue	<u>\$ 135,860,028</u>	<u>\$ 134,209,448</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not collect amounts deemed to be charity care, they are not reported as revenue.

4. INVESTMENTS

Investments are recorded at fair value and consist of the following as of December 31:

	2011	2010
Cash and cash equivalents	\$ 2,483,658	\$ 3,576,654
Mutual funds - equities	8,474,036	8,668,220
Mutual funds - fixed income	8,880,673	8,999,425
	<u>\$ 19,838,367</u>	<u>\$ 21,244,299</u>

5. ASSETS WHOSE USE IS LIMITED

The classification of assets whose use is limited includes:

Internally designated - Amounts transferred by the System's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the System buildings as authorized by IC 16-22-3-13.

Held by trustee - System funds deposited with a trustee and limited as to use in accordance with the requirements of a trust indenture for debt service and capital construction.

Donor restricted – Funds held by the Foundation which are restricted by donors.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets limited as to use includes the following as of December 31:

	2011	2010
Internally designated		
Cash and cash equivalents	\$ 10,912	\$ 10,885
Mutual funds - equities	3,441,863	3,729,374
Mutual funds - fixed income	4,489,651	4,225,050
	<u>7,942,426</u>	<u>7,965,309</u>
Held by trustee		
Cash and cash equivalents	76,049	80,021
Donor restricted		
Mutual funds - equities	623,579	666,311
Total assets whose use is limited	<u>\$ 8,642,054</u>	<u>\$ 8,711,641</u>

6. DEPOSITS AND INVESTMENTS

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are generally carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and mutual funds.

The System's investments generally are reported at fair value. As of December 31, 2011 and 2010, the System had the following investments and maturities, all of which were held in the System's name by custodial banks that are agents of the System:

	December 31, 2011				
	Investment Maturities (in years)				
	Carrying Amount	Less than 1	1-5	6-10	More than 10
Mutual funds - equities	\$ 12,539,478	\$ 12,539,478	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	13,370,324	13,370,324	-0-	-0-	-0-
	<u>\$ 25,909,802</u>	<u>\$ 25,909,802</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

	December 31, 2010				
	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equities	\$ 13,063,905	\$ 13,063,905	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	13,224,475	13,224,475	-0-	-0-	-0-
	<u>\$ 26,288,380</u>	<u>\$ 26,288,380</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

Interest rate risk – The System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk – Statutes authorize the System to invest in interest bearing deposit accounts, passbook savings accounts, certificates of deposit, money market accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Concentration of credit risk – The System maintains its investments, which at times may exceed federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on investments.

Deposits and investments consist of the following as of December 31:

	2011	2010
Carrying amount		
Deposits	\$ 8,223,497	\$ 13,568,861
Mutual funds - equities	12,539,478	13,063,905
Mutual funds - fixed income	13,370,324	13,224,475
	<u>\$ 34,133,299</u>	<u>\$ 39,857,241</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 5,652,878	\$ 9,901,301
Investments	19,838,367	21,244,299
Internally designated	7,942,426	7,965,309
Held by trustee	76,049	80,021
Donor restricted	623,579	666,311
	<u>\$ 34,133,299</u>	<u>\$ 39,857,241</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

7. FAIR VALUE MEASUREMENTS

During 2011, the System changed its accounting policies to expand the level of detail provided on investments and assets whose use is limited by disaggregating mutual funds by investment objective. The change was made to adopt Financial Accounting Standards Board's Accounting Standards Update No. 2010-06, Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements. Accordingly, the accounting change has been retrospectively applied to prior periods presented as if the policy had always been used. The System's assets whose use is limited are reported at fair value in the accompanying consolidated balance sheets.

Fair value is defined as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction value hierarchy, which requires an entity to maximize the use of observable inputs when measuring fair value.

The following provides a description of the three levels of inputs that may be used to measure fair value under the standard, the types of the System's assets whose use is limited that fall under each category and the valuation methodologies used to measure these investments at fair value.

Level 1 Fair Value Measurements

Inputs to the valuation methodology are quoted prices available in the active markets for identical investments as of the reporting date.

The fair value of mutual funds is based on quoted net asset values of the shares held by the System at year-end. The net asset value is based on the value of the underlying assets owned by the fund, minus its liabilities and then divided by the number of shares outstanding. The net asset value is quoted in an active market.

Level 2 Fair Value Measurements

Inputs to the valuation methodology are other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date and fair value can be determined through the use of models or other valuation methodologies.

The fair value of the interest rate swaps is based on expected cash flows over the life of the trade.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Level 3 Fair Value Measurements

Inputs to the valuation methodology are unobservable inputs in situations where there is little or no market activity for the asset or liability and the reporting entity makes estimates and assumptions related to the pricing of the asset or liability including assumptions regarding risk.

The preceding methods used to measure fair value may produce an amount that may not be indicative of net realizable value or reflective of future fair values.

Furthermore, although the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 follows:

	December 31, 2011			
	Total	Level 1	Level 2	Level 3
Assets				
Mutual funds				
Small growth	\$ 597,399	\$ 597,399	\$ -0-	\$ -0-
Mid-cap growth	428,978	428,978	-0-	-0-
Large growth	3,340,926	3,340,926	-0-	-0-
Small blend	775,999	775,999	-0-	-0-
Large value	4,783,161	4,783,161	-0-	-0-
Foreign	899,219	899,219	-0-	-0-
Bond	10,834,206	10,834,206	-0-	-0-
Other	4,249,914	4,249,914	-0-	-0-
Total mutual funds	25,909,802	\$ 25,909,802	\$ -0-	\$ -0-
Cash equivalents	2,570,619			
	<u>\$ 28,480,421</u>			
Investments on balance sheet	\$ 19,838,367			
Assets whose use is limited on balance sheet	8,642,054			
	<u>\$ 28,480,421</u>			
Liabilities				
Interest rate swaps	\$ 8,994,087	\$ -0-	\$ 8,994,087	\$ -0-

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 follows:

	December 31, 2010			
	Total	Level 1	Level 2	Level 3
Assets				
Mutual funds				
Small growth	\$ 674,272	\$ 674,272	\$ -0-	\$ -0-
Mid-cap growth	472,935	472,935	-0-	-0-
Large growth	3,621,908	3,621,908	-0-	-0-
Small blend	768,524	768,524	-0-	-0-
Large value	4,884,327	4,884,327	-0-	-0-
Foreign	856,861	856,861	-0-	-0-
Bond	10,787,612	10,787,612	-0-	-0-
Other	4,221,941	4,221,941	-0-	-0-
Total mutual funds	26,288,380	\$ 26,288,380	\$ -0-	\$ -0-
Cash equivalents	3,667,560			
	<u>\$ 29,955,940</u>			
Investments on balance sheet	\$ 21,244,299			
Assets whose use is limited on balance sheet	8,711,641			
	<u>\$ 29,955,940</u>			
Liabilities				
Interest rate swaps	\$ 4,297,122	\$ -0-	\$ 4,297,122	\$ -0-

The following methods and assumptions were used by the System in estimating the fair value of its financial instruments:

Cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts payable, other current liabilities, salaries, wages and related liabilities and estimated third-party settlements approximate fair value based on short term maturity.

Long term debt: Fair value of the System's variable rate revenue bonds is based on current traded value. The carrying value of loans payable and capital lease obligations approximates fair value based on incremental borrowing rates of similarly rated entities.

Interest rate swaps: The fair value of the interest rate swaps is based on expected cash flows over the life of the trade.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

8. CAPITAL ASSETS

A summary of capital assets includes the following as of December 31:

	December 31, 2010	Additions	Retirements	Transfers	December 31, 2011
Land	\$ 1,002,878	\$ -0-	\$ -0-	\$ -0-	\$ 1,002,878
Land improvements	6,567,713	50,157	-0-	-0-	6,617,870
Buildings and improvements	96,924,110	243,839	-0-	612,649	97,780,598
Equipment	63,614,006	1,216,435	(2,540,109)	236,849	62,527,181
Construction in progress	12,195,376	7,240,222	-0-	(849,498)	18,586,100
Total capital assets	180,304,083	8,750,653	(2,540,109)	-0-	186,514,627
Less accumulated depreciation					
Land improvements	2,522,752	565,999	-0-	-0-	3,088,751
Buildings and improvements	42,288,341	3,420,400	-0-	-0-	45,708,741
Equipment	45,479,772	5,294,035	(2,530,961)	-0-	48,242,846
Total accumulated depreciation	90,290,865	9,280,434	(2,530,961)	-0-	97,040,338
Capital assets, net	<u>\$ 90,013,218</u>	<u>\$ (529,781)</u>	<u>\$ (9,148)</u>	<u>\$ -0-</u>	<u>\$ 89,474,289</u>

	December 31, 2009	Additions	Retirements	Transfers	December 31, 2010
Land	\$ 1,002,878	\$ -0-	\$ -0-	\$ -0-	\$ 1,002,878
Land improvements	6,554,573	59,859	(53,953)	7,234	6,567,713
Buildings and improvements	95,378,684	509,255	(2,163,041)	3,199,212	96,924,110
Equipment	62,421,888	3,402,241	(2,421,139)	211,016	63,614,006
Construction in progress	3,827,495	11,785,343	-0-	(3,417,462)	12,195,376
Total capital assets	169,185,518	15,756,698	(4,638,133)	-0-	180,304,083
Less accumulated depreciation					
Land improvements	1,994,560	579,146	(50,954)	-0-	2,522,752
Buildings and improvements	40,901,943	3,543,594	(2,157,196)	-0-	42,288,341
Equipment	42,276,348	5,496,498	(2,293,074)	-0-	45,479,772
Total accumulated depreciation	85,172,851	9,619,238	(4,501,224)	-0-	90,290,865
Capital assets, net	<u>\$ 84,012,667</u>	<u>\$ 6,137,460</u>	<u>\$ (136,909)</u>	<u>\$ -0-</u>	<u>\$ 90,013,218</u>

Included in construction in progress is the System-wide Electronic Health Record project which began in 2010 and expected to be placed in service during 2012.

9. LONG TERM DEBT

The System has the following bond issues outstanding with the Indiana Financing Authority (IFA) and other local financial institutions as of December 31, 2011 and 2010:

- Series 2005A and 2005B IFA Revenue Bonds, original issue \$30,000,000, Series 2005A and \$20,000,000, Series 2005B, both due through January 2035, variable interest rates of approximately 0.20% for Series 2005A and 0.20% for Series 2005B as of December 31, 2011.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

- Loans payable with local financial institutions, due through 2025 at fixed and variable interest rates ranging from 1.73% to 5.15% as of December 31, 2011, secured by certain System assets.
- Capital lease obligations with imputed interest rates ranging from 3.50% to 6.43% executed for property and equipment are due in monthly or quarterly installments of varying amounts from \$3,194 to \$751,211 including interest, due through 2015. The total cost of the property and equipment (including construction in progress) under capital leases approximated \$9,972,000 and \$15,572,000 as of December 31, 2011 and 2010, respectively and is listed as security for the obligations. The associated accumulated depreciation approximated \$-0- and \$5,600,000 as of December 31, 2011 and 2010, respectively.

The System has two available letters of credit totaling approximately \$46,300,000 with financial institutions for the Series 2005A and 2005B Bonds. The letters of credit are intended to provide credit enhancement and liquidity support for the System's tax-exempt bonds. The letters of credit are collateralized by the Hospital's gross revenues as well as designated assets.

In May 2012, the System and Community Health Network, Inc. (CHNw) approved the Definitive Agreement for CHNw to acquire the assets and liabilities of the System with a signing date of May 31, 2012 and an effective date of July 1, 2012. CHNw will assume all debt of the System, and the System will become part of the CHNw Obligated Group for purposes of debt renewal. Under the debt restructure, the letters of credit will expire in 2015.

See the footnote on Subsequent Events for additional information.

There were no balances outstanding on the letters of credit as of December 31, 2011 and 2010. The debt agreements require the System to maintain certain financial ratios and restrictive covenants. As of December 31, 2011, the System was in compliance with certain financial ratios and covenants. As of December 31, 2010, the System was not in compliance with certain financial ratios and restrictive covenants. The System did obtain waivers for the covenant violations for December 31, 2010. Additionally, the System implemented a performance improvement project in 2011 related to the December 31, 2010 covenant violations.

In the event of liquidity drawing, the System will reimburse the banks in installments through the due dates unless the bonds are remarketed, redeemed or purchased at which time the liquidity advance is due.

HOWARD REGIONAL HEALTH SYSTEM

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The liquidity drawing due date for the Series 2005A letter of credit is 367 days after the liquidity drawing in 24 equal monthly installments. The liquidity drawing due date for the Series 2005B letter of credit is 367 days after the liquidity drawing. Reimbursements of other than liquidity drawings are due on the date such drawings are honored. Accounting guidance requires long term debt backed by a letter of credit to be reported as current if the letter of credit does not provide a long term financing option for liquidity drawings.

A summary of long term debt for 2011 and 2010 follows:

	December 31, 2010	Borrowings	Payments	December 31, 2011	Current Portion
2005 IFA Revenue Bonds	\$ 47,220,000	\$ -0-	\$ (885,000)	\$ 46,335,000	\$ 915,000
Loans payable	12,333,203	-0-	(1,164,460)	11,168,743	902,485
Capital lease obligations	7,787,671	-0-	(2,008,631)	5,779,040	2,788,273
Total long term debt	<u>\$ 67,340,874</u>	<u>\$ -0-</u>	<u>\$ (4,058,091)</u>	<u>\$ 63,282,783</u>	<u>\$ 4,605,758</u>

	December 31, 2009	Borrowings	Payments	December 31, 2010	Current Portion
2005 IFA Revenue Bonds	\$ 48,075,000	\$ -0-	\$ (855,000)	\$ 47,220,000	\$ 885,000
Loans payable	13,368,270	-0-	(1,035,067)	12,333,203	878,802
Capital lease obligations	237,577	9,971,787	(2,421,693)	7,787,671	2,949,587
Total long term debt	<u>\$ 61,680,847</u>	<u>\$ 9,971,787</u>	<u>\$ (4,311,760)</u>	<u>\$ 67,340,874</u>	<u>\$ 4,713,389</u>

The System has interest rate swap agreements related to the Series 2005A and 2005B Bonds. The interest rate swap agreements do not affect the obligation of the System under the indenture to repay principal and interest on the Series 2005A and 2005B Bonds. However, during the term of the swap agreements, the System effectively pays a fixed rate on a portion of the debt. A portion of the debt service requirements to maturity for the Series 2005A and 2005B Bonds are based on that fixed rate. The System will be exposed to variable rates if the counterparty to the swaps defaults or the swap agreements are terminated.

A termination of the swap agreements may also result in the System making or receiving a termination payment. As of December 31, 2011, the variable rates on the Series 2005A and 2005B Bonds were lower than the swap agreements fixed rates. Thus, the amounts reported in the interest rate swap, net column of the below table reflect the difference between the variable rate and swap fixed rate.

See the footnote on Derivative Instruments – Interest Rate Swaps for additional information.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Scheduled maturities for the years subsequent to December 31, 2011 are as follows:

Years Ending December 31,	Principal	Interest	Interest Rate Swap, Net	Total
2012	\$ 4,605,758	\$ 561,271	\$ 1,513,958	\$ 6,680,987
2013	4,195,295	444,791	1,483,185	6,123,271
2014	2,305,745	393,707	1,451,175	4,150,627
2015	1,985,041	406,372	1,417,928	3,809,341
2016	1,712,885	443,094	1,383,608	3,539,587
2017-2021	9,667,822	1,671,542	6,360,503	17,699,867
2022-2026	11,350,237	640,980	5,280,908	17,272,125
2027-2031	14,170,000	257,188	3,394,875	17,822,063
2032-2035	13,290,000	67,938	667,673	14,025,611
	<u>\$ 63,282,783</u>	<u>\$ 4,886,883</u>	<u>\$ 22,953,813</u>	<u>\$ 91,123,479</u>

The System has lines of credit with local financial institutions. The lines bear interest at rates ranging from a fixed rate of 5% to a variable rate of prime less .25%. Outstanding draws are due on demand and are collateralized by System assets. There were no borrowings outstanding on the lines of credit as of December 31, 2011 and 2010.

10. DERIVATIVE INSTRUMENTS – INTEREST RATE SWAPS

Derivative Instruments

During 2010, the System adopted the requirements of GASB No. 53, Accounting and Financial Reporting for Derivative Instruments. The guidance requires governmental entities to evaluate each derivative instrument to determine whether the instrument is an effective hedge.

For those instruments deemed to be an effective hedge, governmental entities are required to practice hedge accounting and the instrument continues to be reevaluated at the end of each future reporting period. Under hedge accounting, the fair value of the instrument is recorded on the consolidated balance sheet with the offsetting entry to deferred outflows or deferred inflows, which also reported on the consolidated balance sheet.

For those instruments deemed to be an ineffective hedge, governmental entities are required to practice investment accounting and the instruments are not evaluated in future reporting periods. Once deemed ineffective, the instrument is considered ineffective for the remainder of its term. Under investment accounting, the fair value of the instrument is recorded on the consolidated balance sheets with the offsetting entry posted to investment income.

HOWARD REGIONAL HEALTH SYSTEM

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The System's interest rate swap agreements were determined to be ineffective hedges as of December 31, 2010. Therefore, the interest rate swap agreements are ineffective through the remainder of the term. As a result, the fair value of the instruments have been recorded as other long term liabilities in the consolidated balance sheets with the offsetting entry recorded under nonoperating revenues (expenses) in the consolidated statements of revenues, expenses and changes in net assets.

Contracts

The System has two interest rate swap agreements in effect as of December 31, 2011 for the IFA Hospital Revenue Bonds, Series 2005A and 2005B.

Objectives and Strategies for Using Derivatives

As a means to manage the risk associated with interest rate risk on its variable rate debt, the System entered into interest rate swaps agreements in connection with its IFA Hospital Revenue Bonds, Series 2005A and 2005B. The intention of the swap agreements was to effectively change the System's variable interest rate on the Series 2005A and 2005B Bonds to fixed rate of 3.55%.

Terms, Fair Values and Credit Risk

The swap agreements relate to the Series 2005A and 2005B Bonds with original notional amounts of \$30,000,000 and \$10,000,000, respectively. The counter party is the same for each swap agreement. The terms and fair values of the outstanding swaps as of December 31, 2011 are as follows:

Original Notional Amount	Current Notional Amount	Effective Date	Fixed Rate	Variable Rate	Fair Value	Termination Date
\$30,000,000	\$27,800,000	10/3/2005	3.550%	0.197%	\$(6,744,349)	1/1/2035
\$10,000,000	\$9,267,500	10/3/2005	3.550%	0.197%	(2,249,738)	1/1/2035
					<u><u>\$(8,994,087)</u></u>	

As of December 31, 2011, the negative fair values of the agreements may be countered by reductions in total interest payments under the swap agreements should the variable rates on the 2005A and 2005B Series bonds increase. The variable rate on the swaps is 70% of the USD-LIBOR BBA and resets monthly.

The counter party is rated A2 by Moody's Investor Service, A- by Standard & Poor's and A by Fitch Ratings.

HOWARD REGIONAL HEALTH SYSTEM

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Basis Risk

The swaps variable rates are pegged to USD-LIBOR-BBA index. The Series 2005A and 2005B Bonds variable rates are determined through remarketing. Therefore basis risk relating to the swaps could be significant.

Termination Risk

The System or the counter party may terminate the swaps if the other party fails to perform under the terms of the contracts. If at the time of termination, the swaps have a negative fair value, the System could be liable to the counter party for a payment equal to the swaps' fair values. As of December 31, 2011, the System was not in compliance with certain terms of the swap contracts. The System obtained a waiver from the counter party as of December 31, 2011.

Swap Payments and Associated Debt

Using rates as of December 31, 2011, debt service requirements of the variable rate debt and net swap payments of the Series 2005A and 2005B Bonds, assuming current interest rates remain the same for the term of the bonds are disclosed in the Long Term Debt note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

The System has determined the swaps to be ineffective hedges. Accordingly, the fair value of the swaps have been recorded and subsequent changes in fair value will be recorded in the consolidated balance sheets with the offsetting entry recorded under nonoperating revenues (expenses) in the consolidated statements of revenues, expenses and changes in net assets.

Following is an analysis of the recording of the interest rate swap agreements:

	<u>2011</u>	<u>2010</u>
Nonoperating revenues (expenses)		
Unrealized loss on interest rate swaps	<u><u>\$ (4,696,965)</u></u>	<u><u>\$ (1,540,599)</u></u>
Other long term liabilities		
Interest rate swaps	<u><u>\$ 8,994,087</u></u>	<u><u>\$ 4,297,122</u></u>

See the Fair Value Measurements and Long Term Debt footnotes for additional information.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

11. PENSION PLAN

The System has a defined contribution pension plan as authorized by IC 16-22-3-11 covering eligible employees who are at least 21 years of age and work 1,000 hours in a plan year. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The current employer contribution rate is 2% of annual covered payroll. The plan was established by written agreement between the System's Board of Trustees and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan.

During 2011, the System established a matching contribution to their 403(b) tax deferred annuity plan for any eligible employee who elects to participate. Participants are generally allowed to participate on the first day of the month on or after becoming an employee. The System matches participant deferrals up to 2% of a participants' eligible compensation.

Total pension expense for 2011 and 2010 was approximately \$1,900,000 and \$2,600,000, respectively, and is reported in employee benefits in the consolidated statements of revenues, expenses and changes in net assets.

12. COMMITMENTS AND CONTINGENCIES

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Leases expire through 2012. Total rental expense in 2011 and 2010 for all operating leases was approximately \$4,202,000 and \$3,885,000, respectively.

Minimum payments under non-cancellable operating lease agreements for December 31, 2012 approximate \$250,000.

13. CONCENTRATIONS

Howard Regional Health System is located in Kokomo, Indiana. The System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The mix of gross receivables and revenues from patients and third-party payors as of and for the years ended December 31, 2011 and 2010 was as follows:

	Receivables		Revenues	
	2011	2010	2011	2010
Medicare	42%	31%	51%	48%
Medicaid	13%	10%	11%	12%
Blue Cross	10%	12%	20%	19%
Other third party payors	13%	14%	12%	13%
Self-pay	22%	33%	6%	8%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

The blended component units of the System maintain cash in accounts, which at times may exceed federally insured limits. The blended component units have not experienced any losses in such accounts. The blended component units believe that it is not exposed to any significant credit risk on cash and cash equivalents.

14. SELF-FUNDED HEALTH INSURANCE

The System is self-funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$150,000 per year with an overall aggregate of \$7,500,000.

Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Self funded health insurance and related expenses were \$4,917,283 and \$5,869,588 in 2011 and 2010, respectively, and are recorded in employee benefits in the consolidated statements of revenues, expenses and changes in net assets. A progression of unpaid claims for 2011 and 2010 follows:

	2011	2010
Unpaid claims, beginning of year	\$ 1,273,553	\$ 1,069,223
Incurred claims and changes in estimates	4,917,283	5,869,588
Claim payments	<u>(5,091,729)</u>	<u>(5,665,258)</u>
Unpaid claims, end of year	<u>\$ 1,099,107</u>	<u>\$ 1,273,553</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

15. INVESTMENTS IN AFFILIATED COMPANIES

North Central Indiana Linen Service, Inc.

The System owns 33% of North Central Indiana Linen Service. The investment is accounted for under the equity method and is recorded in other assets on the consolidated balance sheets. Summarized financial information as of December 31 follows:

	2011	2010
Assets	\$ 1,179,844	\$ 1,185,513
Liabilities	\$ 176,571	\$ 166,625
Equity	\$ 1,003,273	\$ 1,018,888
Revenue	\$ 1,301,339	\$ 1,286,585
Expenses	\$ 1,127,180	\$ 1,252,024
Net income	\$ (15,615)	\$ 34,561

16. ACCOUNTING FOR NON-CONTROLLING INTEREST

The following depicts the changes in consolidated net assets attributable to the controlling financial interest of the System and the non-controlling interest as of December 31, 2011 and 2010:

	Controlling Interest	Non-controlling Interest	Total
Net asset balances			
December 31, 2009	\$ 71,990,733	\$ 2,474,304	\$ 74,465,037
Change in net assets before capital distributions	(7,280,967)	632,238	(6,648,729)
Capital distributions	-0-	(806,176)	(806,176)
Change in net assets	(7,280,967)	(173,938)	(7,454,905)
December 31, 2010	64,709,766	2,300,366	67,010,132
Change in net assets before capital distributions	(9,407,678)	998,090	(8,409,588)
Capital distributions	-0-	(1,084,512)	(1,084,512)
Change in net assets	(9,407,678)	(86,422)	(9,494,100)
December 31, 2011	\$ 55,302,088	\$ 2,213,944	\$ 57,516,032

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

17. STATE AND LOCAL AWARDS

During 2011 and 2010, the System recorded the following state and local awards:

Grantor	Grant Identification	2011	2010
Indiana Division of Mental Health and Addiction & Affiliated Service Providers of Indiana Managed care provider agreement	A55-9-34-10-HO-2710	\$ 1,891,507	\$ 1,960,803
Indiana State Department of Health Community Health Centers	A70-2-079548	128,797	164,923
Tipton County	Not applicable	93,862	91,217
Clinton County	Not applicable	161,730	157,172
Howard County	Not applicable	623,415	605,845
Total state and local awards		<u>\$ 2,899,311</u>	<u>\$ 2,979,960</u>

State and local awards are reported in the consolidated statements of revenues, expenses and changes in net assets under other revenue.

18. SUBSEQUENT EVENT – SYSTEM AFFILIATION

The System, in response to ongoing pressures on operations caused primarily by a downturn in the local economy (decreased utilization, payor mix, and reimbursement) as well as an assessment of the challenges of the future (health care reform, payor consolidation, declining governmental and commercial reimbursement, and increasing charity and bad debt), decided to pursue merger and affiliation opportunities. During 2011, multiple potential interested parties were evaluated, including for profit and not for profit organizations. On January 29, 2012, the System signed a Letter of Intent to negotiate and pursue an affiliation with Community Health Network, Inc. (CHNw). In May 2012, both the System and CHNw boards approved the Definitive Agreement for CHNw to acquire the assets and liabilities of the System. On May 22, 2012, the Board of Trustees of the System as well as the Howard County Council and Howard County Commissioners, passed a resolution to approve the affiliation, with a signing date of May 31, 2012 and an effective date of July 1, 2012. CHNw will assume all debt of the System, and the System will become part of the CHNw Obligated Group for purposes of debt renewal. The affiliation entity will be named Community Howard Regional Health, Inc. (CHRH), and all net assets of the System will, upon the dissolution of the System as a County and Municipal Government entity as of June 30, 2012, be transferred to CHRH. Local governance is a key component of this agreement, requiring that a majority of the CHRH board members be residents of Howard County, an acute care hospital will be maintained in Howard County, and a plan will be created to develop CHRH into a Regional Medical Center.

SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2011

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
ASSETS									
Current assets									
Cash and cash equivalents	\$ 2,735,844	\$ 310,865	\$ 1,078,807	\$ 69,337	\$ 1,313,720	\$ 62,112	\$ 82,193	\$ -0-	\$ 5,652,878
Investments	17,817,565	2,020,802	-0-	-0-	-0-	-0-	-0-	-0-	19,838,367
Patient accounts receivable, net	15,161,399	-0-	1,040,758	-0-	-0-	677,966	66,171	-0-	16,946,294
Other receivables	7,908,934	36,295	8,866	13,872	559,946	-0-	-0-	(5,966,404)	2,561,509
Inventories and other current assets	5,079,939	-0-	295,415	13,002	412,613	20,077	-0-	-0-	5,821,046
Current portion of assets whose use is limited	915,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	915,000
Total current assets	49,618,681	2,367,962	2,423,846	96,211	2,286,279	760,155	148,364	(5,966,404)	51,735,094
Assets whose use is limited									
Internally designated	7,942,426	-0-	-0-	-0-	-0-	-0-	-0-	-0-	7,942,426
Held by trustee	-0-	76,049	-0-	-0-	-0-	-0-	-0-	-0-	76,049
Donor restricted	-0-	623,579	-0-	-0-	-0-	-0-	-0-	-0-	623,579
Total assets whose use is limited	7,942,426	699,628	-0-	-0-	-0-	-0-	-0-	-0-	8,642,054
Less current portion	915,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	915,000
Noncurrent portion	7,027,426	699,628	-0-	-0-	-0-	-0-	-0-	-0-	7,727,054
Capital assets, net	83,185,458	-0-	1,344,709	590,408	366,561	3,949,523	37,630	-0-	89,474,289
Other assets	1,719,388	214,281	594,818	-0-	-0-	-0-	-0-	(1,021,524)	1,506,963
Total assets	<u>\$ 141,550,953</u>	<u>\$ 3,281,871</u>	<u>\$ 4,363,373</u>	<u>\$ 686,619</u>	<u>\$ 2,652,840</u>	<u>\$ 4,709,678</u>	<u>\$ 185,994</u>	<u>\$ (6,987,928)</u>	<u>\$ 150,443,400</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2011

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
LIABILITIES AND NET ASSETS									
Current liabilities									
Accounts payable and accrued expenses	\$ 8,645,443	\$ -0-	\$ 426,260	\$ 1,808,509	\$ 467,394	\$ 2,745,714	\$ 951,636	\$ (5,804,349)	\$ 9,240,607
Accrued liabilities	7,865,692	-0-	525,096	-0-	-0-	92,851	-0-	-0-	8,483,639
Other current liabilities	832,493	46,844	152,755	114,565	-0-	-0-	-0-	(129,299)	1,017,358
Estimated third party settlements	1,908,894	-0-	-0-	-0-	-0-	-0-	-0-	-0-	1,908,894
Current portion of revenue bonds payable	915,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	915,000
Current portion of loans payable	590,894	-0-	-0-	-0-	-0-	311,591	-0-	-0-	902,485
Current portion of capital lease payable	2,653,875	-0-	-0-	-0-	-0-	344,894	-0-	(210,496)	2,788,273
Total current liabilities	23,412,291	46,844	1,104,111	1,923,074	467,394	3,495,050	951,636	(6,144,144)	25,256,256
Long term debt									
Loans payable	9,402,051	210,037	-0-	37,000	-0-	654,170	-0-	(37,000)	10,266,258
Capital lease payable	2,100,682	-0-	-0-	-0-	-0-	890,832	-0-	(747)	2,990,767
Revenue bonds payable	45,420,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	45,420,000
Total long term debt	56,922,733	210,037	-0-	37,000	-0-	1,545,002	-0-	(37,747)	58,677,025
Interest rate swap liabilities and other	8,994,087	-0-	-0-	-0-	-0-	-0-	-0-	-0-	8,994,087
Total liabilities	89,329,111	256,881	1,104,111	1,960,074	467,394	5,040,052	951,636	(6,181,891)	92,927,368
Net assets									
Invested in capital assets, net of related debt	22,102,956	4,244	1,344,709	553,408	366,561	1,748,036	-0-	165,002	26,284,916
Designated									
For debt service	-0-	76,049	-0-	-0-	-0-	-0-	-0-	-0-	76,049
Expendable for capital improvements	7,942,426	-0-	-0-	-0-	-0-	-0-	-0-	-0-	7,942,426
Total designated net assets	7,942,426	76,049	-0-	-0-	-0-	-0-	-0-	-0-	8,018,475
Restricted - donor restricted	-0-	623,579	-0-	-0-	-0-	-0-	-0-	-0-	623,579
Unrestricted	22,176,460	2,321,118	1,914,553	(1,826,863)	1,818,885	(2,078,410)	(765,642)	(3,184,983)	20,375,118
Net assets - controlling interest	52,221,842	3,024,990	3,259,262	(1,273,455)	2,185,446	(330,374)	(765,642)	(3,019,981)	55,302,088
Non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	-0-	2,213,944	2,213,944
Total net assets	52,221,842	3,024,990	3,259,262	(1,273,455)	2,185,446	(330,374)	(765,642)	(806,037)	57,516,032
Total liabilities and net assets	\$ 141,550,953	\$ 3,281,871	\$ 4,363,373	\$ 686,619	\$ 2,652,840	\$ 4,709,678	\$ 185,994	\$ (6,987,928)	\$ 150,443,400

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2011

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
Revenues									
Net patient service revenue	\$ 112,478,065	\$ -0-	\$ 13,752,498	\$ -0-	\$ 7,011,917	\$ 2,236,190	\$ 381,358	\$ -0-	\$ 135,860,028
Other	13,309,485	17,229	764,944	556,267	-0-	(2,692)	-0-	(1,370,991)	13,274,242
Total revenues	125,787,550	17,229	14,517,442	556,267	7,011,917	2,233,498	381,358	(1,370,991)	149,134,270
Operating expenses									
Salaries and wages	47,389,817	-0-	7,130,331	-0-	2,315,181	985,715	-0-	-0-	57,821,044
Employee benefits	10,033,822	-0-	1,729,837	-0-	-0-	67,848	-0-	-0-	11,831,507
Medical professional fees	5,624,656	-0-	760,081	19,803	-0-	285,201	12,555	-0-	6,702,296
Medical supplies and drugs	27,204,479	-0-	853,257	40,617	1,974,753	356,662	47,311	-0-	30,477,079
Purchased services	8,049,902	-0-	712,304	505,582	268,360	247,770	939,335	(191,496)	10,531,757
Equipment rentals	6,285,930	-0-	1,148,147	20,072	964,686	265,951	47,035	(1,160,275)	7,571,546
Utilities and telephone	2,379,494	-0-	362,299	64,056	64,916	132,650	13,590	-0-	3,017,005
Insurance	1,157,244	-0-	62,045	11,859	34,911	41,167	-0-	-0-	1,307,226
Depreciation and amortization	8,291,376	-0-	252,528	88,572	192,793	523,244	-0-	-0-	9,348,513
Other	7,899,550	-0-	162,385	94,732	218,785	141,569	72,134	-0-	8,589,155
Total expenses	124,316,270	-0-	13,173,214	845,293	6,034,385	3,047,777	1,131,960	(1,351,771)	147,197,128
Operating income (loss)	1,471,280	17,229	1,344,228	(289,026)	977,532	(814,279)	(750,602)	(19,220)	1,937,142
Nonoperating revenues (expenses)									
Investment income (loss)	(169,933)	9,636	-0-	-0-	1,487	-0-	-0-	-0-	(158,810)
Interest expense	(2,976,858)	-0-	-0-	(9)	-0-	(87,055)	-0-	20,426	(3,043,496)
Unrealized loss on interest rate swaps	(4,696,965)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	(4,696,965)
Performance improvement project	(2,339,956)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	(2,339,956)
Other nonoperating revenues (expenses)	(274,993)	(477,095)	8,392	-0-	-0-	(25)	(184)	636,402	(107,503)
Nonoperating revenues (expenses), net	(10,458,705)	(467,459)	8,392	(9)	1,487	(87,080)	(184)	656,828	(10,346,730)
Change in net assets before capital distributions and contributions	(8,987,425)	(450,230)	1,352,620	(289,035)	979,019	(901,359)	(750,786)	637,608	(8,409,588)
Capital distributions	-0-	-0-	(1,333,000)	-0-	(1,173,002)	-0-	-0-	1,421,490	(1,084,512)
Capital contributions	-0-	-0-	-0-	-0-	-0-	165,002	-0-	(165,002)	-0-
Change in net assets	(8,987,425)	(450,230)	19,620	(289,035)	(193,983)	(736,357)	(750,786)	1,894,096	(9,494,100)
Net assets									
Beginning of year	61,209,267	3,475,220	3,239,642	(984,420)	2,379,429	405,983	(14,856)	(2,700,133)	67,010,132
End of year	\$ 52,221,842	\$ 3,024,990	\$ 3,259,262	\$ (1,273,455)	\$ 2,185,446	\$ (330,374)	\$ (765,642)	\$ (806,037)	\$ 57,516,032

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2010

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
ASSETS									
Current assets									
Cash and cash equivalents	\$ 6,767,997	\$ 430,151	\$ 1,194,452	\$ 66,067	\$ 1,348,645	\$ -0-	\$ 93,989	\$ -0-	\$ 9,901,301
Investments	18,976,396	2,267,903	-0-	-0-	-0-	-0-	-0-	-0-	21,244,299
Patient accounts receivable, net	14,403,725	-0-	1,241,502	-0-	-0-	299,278	343,576	-0-	16,288,081
Other receivables	5,433,178	51,620	676	13,633	780,823	0	-0-	(4,005,830)	2,274,100
Inventories and other current assets	5,126,711	-0-	323,050	11,012	397,410	35,956	-0-	-0-	5,894,139
Current portion of assets whose use is limited	885,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	885,000
Total current assets	51,593,007	2,749,674	2,759,680	90,712	2,526,878	335,234	437,565	(4,005,830)	56,486,920
Assets whose use is limited									
Internally designated	7,965,309	-0-	-0-	-0-	-0-	-0-	-0-	-0-	7,965,309
Held by trustee	-0-	80,021	-0-	-0-	-0-	-0-	-0-	-0-	80,021
Donor restricted	-0-	666,311	-0-	-0-	-0-	-0-	-0-	-0-	666,311
Total assets whose use is limited	7,965,309	746,332	-0-	-0-	-0-	-0-	-0-	-0-	8,711,641
Less current portion	885,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	885,000
Noncurrent portion	7,080,309	746,332	-0-	-0-	-0-	-0-	-0-	-0-	7,826,641
Capital assets, net	83,680,288	85	785,223	656,627	422,332	4,468,663	-0-	-0-	90,013,218
Other assets	3,647,376	548,298	662,594	-0-	-0-	-0-	-0-	(3,173,886)	1,684,382
Total assets	<u>\$ 146,000,980</u>	<u>\$ 4,044,389</u>	<u>\$ 4,207,497</u>	<u>\$ 747,339</u>	<u>\$ 2,949,210</u>	<u>\$ 4,803,897</u>	<u>\$ 437,565</u>	<u>\$ (7,179,716)</u>	<u>\$ 156,011,161</u>

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2010

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
LIABILITIES AND NET ASSETS									
Current liabilities									
Accounts payable and accrued expenses	\$ 6,928,577	\$ -0-	\$ 370,212	\$ 1,574,195	\$ 569,781	\$ 1,423,865	\$ 452,421	\$ (3,848,869)	\$ 7,470,182
Accrued liabilities and other	7,867,997	-0-	469,948	-0-	-0-	59,006	-0-	-0-	8,396,951
Other current liabilities	523,994	70,045	127,695	120,564	-0-	-0-	-0-	(118,068)	724,230
Estimated third party settlements	771,670	-0-	-0-	-0-	-0-	-0-	-0-	-0-	771,670
Current portion of revenue bonds payable	885,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	885,000
Current portion of loans payable	572,554	-0-	-0-	-0-	-0-	306,248	-0-	-0-	878,802
Current portion of capital lease payable	2,805,115	-0-	-0-	-0-	-0-	407,615	-0-	(263,143)	2,949,587
Total current liabilities	20,354,907	70,045	967,855	1,694,759	569,781	2,196,734	452,421	(4,230,080)	22,076,422
Long term debt									
Loans payable	9,989,824	499,124	-0-	37,000	-0-	965,453	-0-	(37,000)	11,454,401
Capital lease payable	3,814,860	-0-	-0-	-0-	-0-	1,235,727	-0-	(212,503)	4,838,084
Revenue bonds payable	46,335,000	-0-	-0-	-0-	-0-	-0-	-0-	-0-	46,335,000
Total long term debt	60,139,684	499,124	-0-	37,000	-0-	2,201,180	-0-	(249,503)	62,627,485
Interest rate swap liabilities and other	4,297,122	-0-	-0-	-0-	-0-	-0-	-0-	-0-	4,297,122
Total liabilities	84,791,713	569,169	967,855	1,731,759	569,781	4,397,914	452,421	(4,479,583)	89,001,029
Net assets									
Invested in capital assets, net of related debt	19,277,935	49,259	785,223	619,627	422,332	1,553,620	-0-	(35,652)	22,672,344
Designated									
For debt service	-0-	80,021	-0-	-0-	-0-	-0-	-0-	-0-	80,021
Expendable for capital improvements	7,965,309	-0-	-0-	-0-	-0-	-0-	-0-	-0-	7,965,309
Total designated net assets	7,965,309	80,021	-0-	-0-	-0-	-0-	-0-	-0-	8,045,330
Restricted - donor restricted	-0-	666,311	-0-	-0-	-0-	-0-	-0-	-0-	666,311
Unrestricted	33,966,023	2,679,629	2,454,419	(1,604,047)	1,957,097	(1,147,637)	(14,856)	(4,964,847)	33,325,781
Net assets - controlling interest	61,209,267	3,475,220	3,239,642	(984,420)	2,379,429	405,983	(14,856)	(5,000,499)	64,709,766
Non-controlling interest	-0-	-0-	-0-	-0-	-0-	-0-	-0-	2,300,366	2,300,366
Total net assets	61,209,267	3,475,220	3,239,642	(984,420)	2,379,429	405,983	(14,856)	(2,700,133)	67,010,132
Total liabilities and net assets	\$ 146,000,980	\$ 4,044,389	\$ 4,207,497	\$ 747,339	\$ 2,949,210	\$ 4,803,897	\$ 437,565	\$ (7,179,716)	\$ 156,011,161

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2010

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Imaging Center of North Central Indiana	Andrew J. Mandery, MD, LLC	Eliminations	Total
Revenues									
Net patient service revenue	\$ 111,015,570	\$ -0-	\$ 13,963,522	\$ -0-	\$ 6,540,261	\$ 2,029,654	\$ 660,441	\$ -0-	\$ 134,209,448
Other	12,631,284	41,159	836,602	526,565	-0-	(14,070)	-0-	(1,294,520)	12,727,020
Total revenues	123,646,854	41,159	14,800,124	526,565	6,540,261	2,015,584	660,441	(1,294,520)	146,936,468
Operating expenses									
Salaries and wages	51,428,722	-0-	7,094,750	-0-	2,619,251	696,640	-0-	-0-	61,839,363
Employee benefits	11,882,508	-0-	1,782,290	-0-	-0-	54,645	-0-	-0-	13,719,443
Medical professional fees	5,995,925	-0-	720,473	19,946	-0-	232,032	6,131	-0-	6,974,507
Medical supplies and drugs	26,051,145	-0-	906,811	56,885	1,991,621	205,450	26,629	-0-	29,238,541
Purchased services	6,748,815	-0-	732,132	503,310	247,514	289,963	599,733	(191,496)	8,929,971
Equipment rentals	5,789,737	-0-	1,160,622	16,353	940,659	324,868	14,947	(1,072,457)	7,174,729
Utilities and telephone	2,392,719	-0-	341,856	58,998	64,825	116,805	7,580	-0-	2,982,783
Insurance	1,020,618	-0-	68,611	11,262	36,745	45,145	-0-	-0-	1,182,381
Depreciation and amortization	8,609,883	-0-	244,513	90,444	213,998	528,176	-0-	-0-	9,687,014
Other	8,784,394	-0-	224,458	68,913	389,868	105,042	20,677	-0-	9,593,352
Total expenses	128,704,466	-0-	13,276,516	826,111	6,504,481	2,598,766	675,697	(1,263,953)	151,322,084
Operating income (loss)	(5,057,612)	41,159	1,523,608	(299,546)	35,780	(583,182)	(15,256)	(30,567)	(4,385,616)
Nonoperating revenues (expenses)									
Investment income	2,457,283	340,976	-0-	-0-	1,430	-0-	-0-	-0-	2,799,689
Interest expense	(3,084,440)	-0-	-0-	(3)	-0-	(61,142)	-0-	30,567	(3,115,018)
Unrealized gain on interest rate swaps	(1,540,599)	-0-	-0-	-0-	-0-	-0-	-0-	-0-	(1,540,599)
Other nonoperating revenues (expenses)	(153,120)	(109,761)	13,559	-0-	-0-	(10,723)	400	(147,540)	(407,185)
Nonoperating revenues (expenses), net	(2,320,876)	231,215	13,559	(3)	1,430	(71,865)	400	(116,973)	(2,263,113)
Change in net assets before capital distributions	(7,378,488)	272,374	1,537,167	(299,549)	37,210	(655,047)	(14,856)	(147,540)	(6,648,729)
Capital distributions	-0-	-0-	(1,223,290)	-0-	(872,959)	-0-	-0-	1,290,073	(806,176)
Change in net assets	(7,378,488)	272,374	313,877	(299,549)	(835,749)	(655,047)	(14,856)	1,142,533	(7,454,905)
Net assets									
Beginning of year	68,587,755	3,202,846	2,925,765	(684,871)	3,215,178	1,061,030	-0-	(3,842,666)	74,465,037
End of year	\$ 61,209,267	\$ 3,475,220	\$ 3,239,642	\$ (984,420)	\$ 2,379,429	\$ 405,983	\$ (14,856)	\$ (2,700,133)	\$ 67,010,132

See report of independent auditors on pages 1 and 2.